est.[160]

Special Agreements and Covenants

The FCC has sometimes permitted a licensee to enter into agreements with an alien investor that give the investor special rights with respect to the station's operations, without violating section 310(b).[161] For example, the FCC has approved a "traffic" agreement between a microwave licensee and a company controlled by aliens that gave the alien company the right to lease up to 90 percent of the licensee's transmission capacities.[162] The parties had also executed a management agreement that ensured that the licensee would control the operation of the station.[163]

The FCC has approved turnkey agreements between a licensee and an alien investor.[164] Under these agreements, the licensee transfers its licenses to another corporation, while retaining certain rights to use the facilities in question. Because it no longer holds the licenses, the proposed transferee may then accept funding from alien sources without violating section 310(b). The FCC will not allow these agreements if the former licensee retains control over the operation of the station.[165]

Finally, a minority shareholder may safeguard an ownership interest that complies with section 310(b) through covenants give him the right to block certain transactions or changes in the licensee's bylaws.[166]

Use of any of these agreements, particularly in combina-

160. *See id.* at 42-43.

161. *See id.* at 43-44, 49.

162. Licensee, Ltd. Partnership, 5 F.C.C. Rcd. 1673, 1673 ¶ 7 (1990).

163. Gavillet, Foehrkolb & Wu, *supra* note 19, at 44.

164. Bloomington-Normal MSA Ltd. Partnership, 2 F.C.C. Rcd. 5427, 5428 ¶ 8 (1987).

165. *See, e.g.*, *Telemundo*, 802 F.2d at 513; *STARS/TOPS*, *discussed in* Gavillet, Foehrkolb & Wu, *supra* note 19, at 45.

166. *Id.* at 48.

tion with other interests in the licensee, could result in the FCC's finding that the alien has de facto control of the licensee.[167]

HYPOTHETICAL TRANSACTION

Business planning under section 310(b) involves the interplay of the alien ownership and management restrictions and the FCC's ownership attribution rules. Consider the hypothetical sale of a licensee called American. If it appears that an alien bidder, Alien Corp., is unlikely to receive a waiver that would enable it to acquire control of 51 percent or more of American's common carrier activities, it may be necessary to create from American four separate firms to facilitate its sale. The following analysis, in other words, assumes that a waiver has been denied or is improbable.

Isolating Licenses Not Subject to Section 310(b)

The first of these four firms, call it American Exempt Corp., would be created to hold all radio licenses granted to American that are exempt from section 310(b). This firm could be sold in its entirety to Alien Corp.[168] The assets and licenses of this firm, therefore, would be likely to fetch a higher price than if they were subsumed in an entity holding licenses subject to section 310(b). In other words, in the absence of a waiver, the whole of American might be worth less than the sum of its parts.

Creating a Domestic Holding Company in Which Aliens Could Invest

167. *Id.* at 46, 48.

168. *See id.* at 46–47; Telefónica Larga Distancia De Puerto Rico, 8 F.C.C. Rcd. 106, 107 ¶ 4 (1992).

Investment without Waiver. Next, American would create a holding company, American Holding Corp., which would be organized under American law. American Holding Corp. would own 51 percent (or more) of an American corporation that would control American's licenses (described in greater detail below). Alien Corp. would acquire 25 percent of the voting equity of this holding company, as section 310(b)(4) permits. In addition, American Holding Corp. could have aliens occupying one-fourth of the sets on its board, although this could be superfluous from Alien Corp.'s perspective as long as it could find American citizens who would share its interests on the board.

Investment with Waiver. It is possible that Alien Corp. could increase its stake in American Holding Corp. above 25 percent (to 51 percent) by requesting a waiver under section 310(b)(4). Whether Alien Corp. would desire such a waiver would depend on its ownership and control objectives with respect to American. In general, there are three alternative investment objectives that Alien Corp. might have that would necessitate a waiver: (1) maximizing cash flows by maximizing its (passive) ownership in American; (2) exercising management control of American (but not necessarily the rights to all of American's net cash flows); and (3) exercising control *and* maximizing rights to net cash flows from American.

If the alien investor were relatively more concerned about control than cash flow, American Holding Corp. could be capitalized with dual classes of stock (voting and non-voting, or voting and super-voting) so that control and ownership could be separated; consequently, control of the holding company would be associated with less than 51 percent of the firm's net cash flows. From Alien Corp.'s perspective, this arrangement might be desirable, because it would not have to acquire any more equity in American Holding Corp. than what was necessary to exercise 51 percent control. Shares in American Holding Corp. would carry the restriction that they could not be transferred to

aliens if doing so would increase the alien ownership or control of the corporation.

Entity to Hold Licenses Subject to Section 310(b). American would create a third firm, American License Corp., to hold all of its licenses subject to section 310(b). American Holding Corp. would acquire at least 51 percent control of this firm. Shares in American License Corp. would carry the restriction that they could not be transferred to aliens if doing so would increase the alien ownership or control of the corporation.

Entity to Hold Complementary Assets. American would create a fourth firm, American Asset Corp., to hold the assets used in conjunction with the radio common carrier licenses granted to American. This firm would not be an FCC licensee, and its ownership and control therefore would not be subject to section 310(b). Consequently, it could be acquired entirely by Alien Corp.

American Asset Corp. would enter into a long-term lease of equipment to American Lease Corp. In return, American Asset Corp. would receive rental payments and the standard representations and warranties associated with an equipment lease. The lease could have inflation-escalation and profit-pass-through provisions, but it could not so closely approximate an equity investment to be recast as an ownership interest cognizable under section 310(b).

Similarly, American License Corp. would enter into contractual arrangements with American Exempt Corp. (owned by Alien Corp.) for non-common-carrier services.

It is also possible that American License Corp. could enter into a debt agreement with Alien Corp. (for example, the funds with which to rent equipment from American Asset Corp.). Alien Corp. would receive payments of interest and principal and also would receive the usual representations and warranties of a creditor. This debt agreement would have to be commercially reasonable, or else it could be recast as equity or

as an exercise of de facto control (assuming that Alien Corp. had not secured a waiver permitting it to exercise control); even subject to this constraint, however, the debt agreement would afford Alien Corp. an additional degree of influence over American License Corp. that would be legally distinguishable from control for purposes of section 310(b).

It is significant that reversing the transactional structure described above might create problems under section 310(b). While the entity holding licenses subject to section 310(b) could lease equipment and secure debt financing, an entity that held equity equipment or had capital available to lend could not "borrow" radio common carrier licenses without causing a transfer of control, including a transfer of control to an alien.

CONCLUSION

Every strategy that an alien investor must adopt to avoid contravening section 310(b) forces him to run a gauntlet of transaction costs. The strategies that an investor may adopt to increase its investment in a radio licensee subject to section 310(b) require extensive planning by high-priced lawyers. The agreements must have the FCC's prior approval, sometimes entailing hearings and appeals. And all of the investor's potential competitors will be alerted to come have their say in the matter, too. Ultimately, no strategy that an investor may adopt in maximizing its interest in a radio licensee enables it to minimize the agency costs of monitoring the licensee. Control of the licensee itself remains separated from ownership. For every investor who decides to spend the resources necessary to invest in a radio licensee subject to section 310(b), many other investors surely decide not to bother.

A defender of section 310(b) might argue that, while the statute does impose these costs, it provides the desired benefit for the public interest—namely, protecting national security by ensuring that alien investors do not control radio licensees. Like the costs, our hypothetical defender might argue, the magnitude

of that benefit is inestimable. Congress has simply decided that an inestimable benefit outweighs an inestimable cost.

There are several problems with this analysis. As an instrument of national security, section 310(b) is ineffectual. Chapter 2 documented the historical evidence on this score. The point is further supported by the gaping loopholes in section 310(b)'s coverage, as chapter 3 showed. Section 310(b) allows aliens to use common carrier and most private carrier radio networks as the customer of a licensee. It does not prevent aliens from buying cable television systems or wireline telephone companies. Yet propagandists, spies, and saboteurs have not inflicted any known damage by use of these media. Indeed, one must wonder whether a true enemy of the U.S. would even bother to get a radio license from the FCC before using the airwaves. The vast majority of alien investors surely pose no danger to the national security whatsoever. If a tiny minority of them do, the President possesses ample means, detailed in chapter 3, to deal with the problem at much lower cost to the nation. In this respect, then, section 310(b) imposes costs without deriving any real benefit whatsoever.

Despite this burdensome statute, some aliens do make substantial investments in U.S. radio licensees. And, just as an infinite number of monkeys typing on an infinite number of typewriters will eventually produce *War and Peace*, enough lawyers can invent ways around section 310(b) to keep the FCC busy for generations to come. The statute's principal effect, then, is to prevent foreign investors from investing in American companies in the manner that minimizes transactions costs and agency costs. Section 310(b) is equivalent to a law requiring foreign investors and U.S. radio licensees to dump truckloads of cash into the ocean before completing any affiliation.

5

Foreign Direct Investment in the United States

SUBSTANTIAL BENEFITS flow from foreign direct investment. Foreign direct investment in U.S. telecommunications service providers can reduce their cost of capital and increase their access to new technologies and management techniques. These two factors in turn are likely to heighten competition in the U.S. market, benefiting all consumers of telecommunications services. With greater domestic competition and the increased likelihood of access to foreign markets that would result from a policy of permitting more foreign investment in U.S. telecommunications, U.S. firms will be better conditioned to compete in the delivery of telecommunications services on a global scale. The few significant foreign investments that have been made in U.S. telecommunications service providers illustrate these benefits of foreign direct investment and suggest the potential gains from U.S. policies that are more hospitable to such investment.

THE CAUSES OF FOREIGN DIRECT INVESTMENT

Firms invest abroad to obtain competitive advantages stemming from technological knowledge, management skills, and vertical integration of suppliers.[1] The need to control the activities of firms operating in other countries is, according to the influential theory of Steven Hymer, the driving force behind foreign direct investment.[2] Hymer theorized that the advantage of foreign direct investment may arise from imperfect competition. A firm might have special access to information about production and a means of capturing increasing returns to scale.[3] For example, a foreign firm with exclusive access to valuable information might outbid a domestic firm for land and plant in an industry.

Extending this analysis, Edward Graham and Paul Krugman suggest that a foreign firm might possess some firm-specific knowledge or assets that enable it to manage the U.S. firm more ably than its American managers.[4] In a related vein, Robert Lipsey claims that overseas investment enables a firm to raise the value of its firm-specific assets—for example, its technologies, patents, or unique skills—by extending the range of markets it can serve.[5] Even modern game theory supports the competitive advantage framework. Taking the reactions of a firm's competitors into account, Graham has developed a model to explain the strategic decision making of

1. *See* James R. Markusen, *The Boundaries of Multinational Enterprises and the Theory of International Trade*, 9 J. ECON. PERSPECTIVES 169 (1995).

2. STEVEN H. HYMER, THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT (MIT Press 1976).

3. *Id.* at 25-30.

4. *See* EDWARD M. GRAHAM & PAUL R. KRUGMAN, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES 35-36 (Institute for International Economics 3d ed. 1995).

5. Robert Lipsey, *Outbound Direct Investment and the U.S. Economy*, 4691 NAT'L BUREAU ECON. RES. 1, 1 (1994).

multinational enterprises.[6] Under the assumptions of two monopolistic firms facing constant marginal costs and possessing complete information, he finds, not surprisingly, that the lower a firm's relative marginal costs are to its foreign rival and the smaller the relative size of a firm's market is to the foreign market, the greater the probability that the firm will choose to enter the rival's market.

Other explanations exist for foreign direct investment that are unrelated to Hymer's theory. For example, foreign direct investment may allow multinational enterprises to retain or increase world market share in the face of fluctuating exchange rates. Diversification of a multinational enterprise's portfolio reduces risks such that if one locale suffers a productivity shock, the firm can shift resources to a country where productivity is higher. Firms may also invest abroad to circumvent trade barriers or to gain proximity to foreign consumers.

FOREIGN DIRECT INVESTMENT IN THE U.S.

By the end of 1993, foreign direct investment in the U.S. (FDIUS) was $445.2 billion.[7] Despite this high level, foreign investment slowed between the 1980s and the early 1990s, and there has been a trend of U.S. affiliates incurring losses or paying dividends to foreign parents in excess of current earnings. In 1995, however, there was evidence of a resurgence in

6. Edward Graham, *Strategic Management and Transnational Firm Behavior: A Formal Approach, in* THE NATURE OF THE TRANSNATIONAL FIRM 1, 1 (C.N. Pitelis & R. Sugden eds., Routledge 1991).

7. U.S. DEP'T OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, SURVEY OF CURRENT BUSINESS, vol. 74, no. 8, at 98 (Aug. 1994). The Bureau of Economic Analysis measurement records historical costs rather than market value (estimated to be $745.6 billion at the end of 1993) and includes earnings retained by subsidiaries in the U.S. and transfers of funds from parent firms. The figure omits subsidiaries' investments financed from borrowed funds within the U.S. or from a third country.

FDIUS.[8]

What caused the surge in FDIUS during the 1980s? A popular explanation is the increased competitiveness of companies in Europe, Japan, and Canada relative to their U.S. rivals.[9] There are at least four other explanations. One is that the share of production capacity located abroad increases as exchange rate volatility rises.[10] A second theory links the surge in FDIUS to the value of the dollar: As the dollar falls, exports to the U.S. slow, and U.S. productive assets and U.S. labor become cheaper.[11] A third theory attributes the rise in FDIUS to foreign firms' lower cost of equity: When a foreign stock exchange discounts future earnings at a lower rate than the New York Stock Exchange, foreign firms can offer higher bids than their U.S. rivals.[12] A fourth theory is that FDIUS is a means to evade actual or potential U.S. tariffs and other trade barriers, as may be the case with the production of Japanese automobiles and color televisions in the U.S.[13]

Foreign owned firms currently represent a substantial share of total U.S. manufacturing production. The four major industry groups in the manufacturing sector that absorbed the greatest amount of FDIUS are chemicals, industrial machinery and equipment, electronics, and transportation equipment.[14]

8. Bernard Wysocki, *Foreigners Find US a Good Place to Invest*, WALL ST. J., Aug. 7, 1995, at A1.

9. EDWARD M. GRAHAM & PAUL R. KRUGMAN, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES 44 (Institute for International Economics 2d ed. 1991) [hereinafter GRAHAM & KRUGMAN 2D ED.].

10. Lee Goldberg & Charles Kolstad, *Foreign Direct Investment, Exchange Rate Variability and Demand Uncertainty*, 4815 NAT'L BUREAU ECON. RES. 1, 15 (1994).

11. Cletus Coughlin, *Foreign Owned Companies in the United States: Malign or Benign?*, 74 FED. RESERVE BANK ST. LOUIS 17, 24 (1992).

12. Robert Laster & Martin McCauley, *Making Sense of the Profits of Foreign Firms in the U.S.*, 19 FED. RESERVE BANK N.Y. Q. REV. 44, 47 (1994).

13. Coughlin, *supra* note 11.

14. GRAHAM & KRUGMAN 2D ED., *supra* note 9, at 42.

FDIUS is mainly characterized by acquisitions of existing plants (88 percent in 1990) rather than "greenfield" investment in the construction of new sites.[15] The leading source countries of FDIUS in 1993 were Japan (21 percent), the U.K. (21 percent), and the Netherlands (15 percent).[16]

Job Creation

By 1988, FDIUS provided nearly 9 percent of all U.S. manufacturing jobs.[17] It is difficult, however, to credit foreign firms with the actual creation of jobs in the U.S. economy. FDIUS has little effect on the number of local jobs but instead represents the transfer of ownership from the U.S. to a foreign firm.[18] Graham and Krugman argue that the increased demand for labor as a result of foreign direct investment only influences employment levels in the short run, and they conclude that the net impact of FDIUS on the number of U.S. jobs is negligible in the long run.[19] Rachel McCulloch argues that when jobs abroad are sacrificed as a result of FDIUS, global demand falls enough to offset the gains in U.S. jobs in the targeted industry with job losses in other sectors of the domestic economy, and that those losses are accelerated by foreign firms' propensity to source from abroad.[20]

If there is little evidence that FDIUS creates jobs in the U.S., it is even more questionable that FDIUS *destroys* jobs in the U.S. Nonetheless, Clyde Prestowitz, founder of the

15. *Id.* at 24.

16. *Id.* at 22.

17. Coughlin, *supra* note 11, at 19.

18. Norman Glickman & Dennis Woodward, *Industry Location and Public Policy, in* REGIONAL AND LOCAL DETERMINANTS OF FOREIGN FIRM LOCATION IN THE UNITED STATES 190, 191 (Henry W. Herzog, Jr. & Alan M. Schlottman eds., University of Tennessee Press 1991).

19. GRAHAM & KRUGMAN, *supra* note 4, at 60–62.

20. Rachel McCulloch, *Foreign Investment in the U.S.*, 30 FIN. & DEV. 13, 15 (1993).

Economic Strategy Institute, envisions massive job losses in the U.S. airline industry once British investors are allowed access.[21] He reasons as follows. The partial acquisition of USAir by British Air would result in the loss of 3,500 jobs to the U.S. economy.[22] Without corresponding access to the British market, U.S. carriers could not provide one-stop flights from midsize markets in the U.S. to London. As British Air gains more of the transatlantic market, it may transfer U.S. jobs to Britain in large numbers. Prestowitz, however, neglects to address, among other countervailing factors, the extent to which British investors would reinvest in their American subsidiaries the profits earned in the U.S.

Another concern that FDIUS arouses is the "headquarter effects," or the extent to which foreign owners shift R&D activities outside the U.S. To test this claim, Cletus Coughlin compared R&D expenditure per worker in the manufacturing sector for U.S.-based and foreign-based multinationals operating in the U.S and found that U.S. firms spend only slightly more per worker on R&D ($4,640 versus $3,780) than their foreign-based counterparts.[23] If foreign owners were actually shipping R&D jobs overseas, then one would expect to see a larger divide between what foreign-owned and American-owned manufacturing firms spent in the U.S. Coughlin's result suggests that R&D jobs do *not* go overseas as foreigners increase their ownership of U.S. assets.

Wages

A major concern to policy makers is how foreign affiliates treat U.S. workers. Statistics show similar value added per worker and compensation between foreign affiliates and U.S.

21. CLYDE V. PRESTOWITZ, JR., THE FUTURE OF THE AIRLINE INDUSTRY (Economic Strategy Institute 1993).

22. *Id.* at 34.

23. Coughlin, *supra* note 11, at 27.

firms within the same industry.[24] There is even some evidence that foreign firms pay their U.S. workers more handsomely than do American-owned firms. One study found that workers of foreign affiliates in chemicals and transportation equipment earned 20 percent more per hour than the average U.S. worker in manufacturing in 1992,[25] although it must be noted that workers employed by U.S.-based firms in those industries also earn higher wages than the average manufacturing workers.

Measuring pay in terms of compensation per employee including employee benefits, another study found that workers of foreign-owned affiliates earned $5,300 more than their counterparts employed by U.S.-owned firms ($38,300 compared to $33,000).[26] Sixty percent of the difference was due to the mix of industries—if U.S. based firms invested in the same industries as U.S. affiliates of foreign firms, the wage disparity would be greatly reduced. In an effort to explain the wage disparity within an industry, the study used regression analysis to control for plant size and capital intensity. Foreign ownership could not explain the change in wages, and it should therefore be *associated*, but not credited, with higher wages.

Productivity

Foreign investment provides both direct and indirect benefits to the host countries with regard to productivity. Foreign direct investment directly increases productivity by providing host countries with access to modern technology that they

24. GRAHAM & KRUGMAN, *supra* note 4, at 71–72.

25. JAN ONDRICH & MICHAEL WASYLENKO, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES 162 (Upjohn Institute 1993).

26. Ned Howenstice & William J. Zeile, *Characteristics of U.S. Manufacturing Establishments*, *in* U.S. DEP'T OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, SURVEY OF CURRENT BUSINESS, vol. 74, no. 8, at 34, 45 (Aug. 1994).

cannot provide themselves.[27] Indirectly, foreign direct investment boosts productivity through "intraindustry" and "interindustry" spillovers. Intraindustry spillover involves those effects which influence the efficiency of the host country's existing producers. Interindustry spillovers benefit local suppliers and customers. Such spillovers include increased competition that forces existing inefficient firms to raise investment in physical and human capital; advanced training techniques for labor and management that diffuse throughout the general economy; and sophisticated techniques of intermediate supply in areas such as quality control, reliability, and speed of delivery. Magnus Blomstrom defends the "spillover benefit hypothesis" with evidence that productivity levels of domestic firms increase with the foreign subsidiaries' share of the market.[28]

When capital stocks increase, productivity and wages should rise. Since foreign firms are credited with increasing the host country's capital stock, should they also be credited with increasing productivity and wages for American workers? Commerce Department data reveal that foreign firms in the U.S. had higher levels of productivity than their domestic counterparts in 1990. Labor productivity (as measured by the value added per production hour) was $22 higher in foreign-owned manufacturing firms than their U.S.-owned counterparts.[29] Similar to the breakdown for wage differentials, 70 percent of the difference was due to the effects of industry mix and 20 percent was due to the effects within industry. After controlling for plant size, capital intensity, and employee skill level, the study concluded that the difference in productivity due to foreign ownership was insignificant.

27. Magnus Blomstrom, *Host Country Benefits of Foreign Investment*, 3615 NAT'L BUREAU ECON. RES. 1, 1 (1991).

28. *Id.*

29. Howenstice & Zeile, *supra* note 26, at 42.

Output

Some proponents of FDIUS oppose states offering incentive packages to lure foreign direct investment. Their argument is that such packages transfer wealth from state taxpayers to the foreign firms and that such transfers entail a loss in U.S. output because of the inefficiency of redistributing income through the political process.[30]

Apart from the question of the possible inefficiency of such incentive packages, one would expect FDIUS to expand U.S. output by augmenting capital shortfalls and raising the productivity of U.S. workers. Modern capital stocks elicit technological advancements and make the U.S. more competitive in the global economy. One study tested the proposition that foreign firms establish themselves in the U.S. to copy ideas and export them back to the parent company. Its method was to examine the receipts of royalties and licenses transferred between foreign parents and their U.S. affiliates. If foreign firms were copying U.S. ideas, then one would expect to see a net flow of funds from the foreign parents to the domestic affiliates. To the contrary, the study found that in 1990 U.S. affiliates paid six times as much on royalties as their foreign parents.[31] The study concluded that the transfer of technology moves from the parent to the U.S. affiliate.

Trade

The trade deficit for U.S. affiliates of foreign firms peaked at $95.4 billion in 1987 and has since declined to $90.6 billion in 1990 and $81.5 billion in 1992.[32] The common explanations

30. Glickman & Woodward, *supra* note 18, at 201.

31. Coughlin, *supra* note 11, at 23.

32. William J. Zeile, *Foreign Direct Investment in the United States: 1992 Benchmark Survey Results, in* U.S. DEP'T OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS, SURVEY OF CURRENT BUSINESS, vol. 74, no. 7, at 154 (July 1994);

for that deficit are the natural import bias of the types of firms targeted by foreigners (for example, wholesalers) and the tendency of affiliates to source, at least initially, from their foreign parents.

Graham and Krugman argue that the latter factor is a small contributor to the trade deficit.[33] They examined exports per worker in both U.S. foreign affiliates and parent companies of U.S.-based multinational enterprises. In 1990, foreign multinational manufacturing firms imported approximately $21,000 of materials per worker versus only $12,000 per worker for domestically owned firms.[34] Nonetheless, that pattern is understandable. New assembly initially requires imported inputs while foreign affiliates familiarize themselves with local suppliers. Over time, this dependency on imports diminishes. For example, the domestic content of Honda automobiles manufactured in the U.S. rose from an initial 30 percent to 60 percent by 1987.[35]

THE BENEFITS OF FOREIGN DIRECT INVESTMENT IN U.S. TELECOMMUNICATIONS SERVICES

In addition to capturing some of the general benefits of foreign direct investment described above, the U.S. can gain in at least four specific ways from opening its telecommunications industry to greater foreign direct investment.

U.S. DEP'T OF COMMERCE, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES: AN UPDATE 78 (Government Printing Office 1993).

33. GRAHAM & KRUGMAN, *supra* note 4, at 70.

34. *Id.*

35. *Id.* at 79 (citing GENERAL ACCOUNTING OFFICE, FOREIGN INVESTMENT: GROWING JAPANESE PRESENCE IN U.S. AUTO INDUSTRY (Government Printing Office 1988)).

Increased Competition in U.S. Telecommunications Services

Foreign investment can increase competition in the market for telecommunications services in the U.S., which improves quality and decreases prices for American consumers. There can be little doubt, for example, that AT&T will face greater competition in its integration of its wireline long-distance facilities and its newly acquired McCaw Cellular wireless facilities because of BT's investment in MCI and because of Deutsche Telekom's and France Télécom's proposed investment in Sprint (which, in turn, has bid to be the largest holder of PCS licenses through its WirelessCo venture with TCI and other cable MSOs). Such competition would be one means to drive down the high price-cost margins, net of access charges, that Paul MacAvoy has shown to exist in various segments of the long-distance market.[36] Likewise, one could imagine another foreign carrier (such as Canada's BCE or the U.K.'s Cable & Wireless, both of which already have extensive fiber networks in North America) investing in AirTouch or the spinoff of Sprint's cellular operations or the possible spinoff of the combined cellular operations of NYNEX and Bell Atlantic.

As chapter 6 will document, the liberal foreign investment policies in New Zealand and the U.K. have contributed significantly to the growth of competition in those markets. The growth of cable telephony in the U.K. can be linked to the lifting of foreign investment restrictions, which produced an influx of direct investment (and, with it, technological and managerial expertise) from American and Canadian telephone and cable television companies. Likewise, competition in local telephony in New Zealand probably would not have occurred

36. Paul W. MacAvoy, *Tacit Collusion Under Regulation in the Pricing of Interstate Long-Distance Telephone Services*, 4 J. ECON. & MGMT. STRATEGY 147 (1995).

without the foreign direct investment in Clear Communications by MCI and Canada's BCE.

Reduced Cost of Capital

Foreign direct investment increases the supply of capital in the U.S. This influx decreases the cost of capital for U.S. telecommunications firms, which enables them to fund greater levels of expansion than would be possible in the presence of a higher cost of capital.

Some argue that foreign direct investment is not needed in the U.S. telecommunications market because U.S. capital markets can accommodate all the debt or equity offerings that U.S. telecommunications companies want to undertake. This argument is familiar and ironic. When U.S. cable television firms sought in 1976 to have the FCC apply section 310(b) to their industry, they curiously argued, in the FCC's words, that the FCC's "failure to restrict alien ownership now may in fact encourage foreign participation due to the industry's present financial plight."[37] In other words, foreigners who could engage in direct investment in U.S. cable systems might be willing to assume financial risks that American investors would refuse to bear at the same return on capital.

Four years later, when U.S. cable companies again tried and failed to impose foreign ownership restrictions, they made just the opposite argument: Foreign capital was unnecessary to fund their industry's growth.[38] Yet, by the late 1980s,

37. Amendment of Parts 76 and 78 of the Commission's Rules to Adopt General Citizenship Requirements for Operation of Cable Television Systems and for Grant of Station Licenses in the Cable Television Relay Service, Report and Order, Dkt. No. 20621, 59 F.C.C.2d 723, 725 ¶ 6 (1976).

38. Amendment of Parts 76 and 78 of the Commission's Rules to Adopt General Citizenship Requirements for Operation of Cable Television Systems and for Grant of Station Licenses in the Cable Television Relay Service, Memorandum Opinion, 77 F.C.C.2d 73, 75 ¶ 6 (1980).

the industry was highly leveraged and opposed the reimposition of rate regulation in 1992 in part because it would impair the ability of cable systems to service their massive debt. In other words, even *with* the unrestricted foreign direct investment that it so much wanted to prevent, the U.S. cable industry faced oppressively high capital costs.

Indeed, the unique institution of regulation in the U.S. may be a factor that, if not reformed over time, will increasingly constitute a risk for investment in U.S. telecommunications that requires a premium in the cost of capital relative to the cost of capital for telecommunications firms in other capitalist democracies (such as New Zealand, U.K., or Chile) that privatized their PTTs but did not then emulate America's burdensome regulatory apparatus.

Positive Externalities in Technology and Management

Foreign direct investment may generate beneficial spillovers for U.S. telecommunications firms. These benefits consist of the transfer of new technology and management practices to U.S. firms and their workers. Americans may be accustomed to thinking that U.S. firms consistently are in the vanguard of new technologies. But this view assumes that the current pace of innovation in the U.S. market is independent of the threat of future foreign competition. As the technology developed by U.S. firms is diffused and used throughout the world, the gap in competitiveness between U.S. and foreign telecommunications firms will lessen.

Moreover, something that is unique to the U.S. telecommunications market—namely, the heavy hand of seventy years of FCC regulation and antitrust decrees—denies U.S. firms many of the economies of scope from research and development across multiple product lines that foreign firms can exploit. A principal goal of the Modification of Final Judgment, after all, has been to limit collaboration between

manufacturers of telecommunications equipment and the Bell operating companies, which build and manage most of the nation's public telecommunications networks.[39] Thus there is reason to suspect that foreign direct investment in the RBOCs by overseas equipment manufacturers (such as Siemens or Ericsson or Fujitsu) would, when Congress or the MFJ court eventually permits such investment to occur, produce especially valuable technology transfers. If the market for knowledge is imperfect because of free riding, firms may be less inclined to sell or license their latest technology to firms in another country than to transfer it to them through foreign direct investment. Policy makers may overlook this benefit from foreign direct investment because spillovers are difficult to measure; but spillovers matter, as strategic trade theorists have appropriately emphasized.

Enhanced Globalization

Foreign direct investment in telecommunications service providers is inevitable given the trend toward globalization observed in many industries. Telecommunications service providers are competing to offer the full array of global services demanded by the 2,400 multinational corporations worldwide, 800 of which are in Europe alone.[40] The international integration of networks and services that will be necessary to meet that demand will require billions of dollars of investment.

39. *See* Affidavit of Robert W. Lucky, Motion of Bell Atlantic Corporation, BellSouth Corporation, NYNEX Corporation, and Southwestern Bell Corporation to Vacate the Decree, United States *v.* Western Elec. Co., No. 82-0192 (D.D.C., filed July 6, 1994) (affidavit by Vice President of Applied Research, Bell Communications Research (Bellcore), describing how the manufacturing restriction in the MFJ has impeded Bellcore's ability to ensure network reliability and to participate in the development of new products).

40. Andrew Adonis, *Best form of defence: Andrew Adonis explains the competitive pressures leading to international alliances*, FIN. TIMES, June 16, 1994, at 13.

Consequently, barriers to foreign direct investment will impede any aspiring "supercarrier."

Consider the ambitions of the U.S. long-distance carriers. MCI and Sprint evidently lack the financial or political might to establish themselves independently as end-to-end full-service providers on a global scale. Each found one or more European partners and will use the resulting direct investment to fund further expansion. In contrast, many nations may fear AT&T as the world's largest carrier and thus justify protectionist measures, aimed at impeding AT&T's expansion, by pointing to America's own foreign ownership restriction. As of 1995, AT&T had limited itself to alliances with Unisource (a marketing joint venture with Telia of Sweden, Swiss PTT, KPN of the Netherlands, and Telefónica de España) and WorldPartners, a similar venture in Asia with Kokusai Denshin Denwa of Japan and Singapore Telecom.[41]

THE EXTENT OF FOREIGN DIRECT INVESTMENT IN U.S. TELECOMMUNICATIONS SERVICES

The significant foreign direct investments in U.S. telecommunications companies have had to accommodate the constraints of section 310(b). When the structure of a particular deal has required the FCC to waive the 25 percent ownership benchmark in section 310(b)(4), the agency has generally decided that a waiver would serve the public interest if the benchmark would be only slightly exceeded or if the investment would facilitate inconsequential entry into the U.S. market.

BT and MCI

In June 1994, the Department of Justice filed suit and a proposed consent decree in response to BT's proposal to purchase

41. AT&T CORP., 1994 SEC FORM 10-K, at 5 (1995).

20 percent of MCI and to create an international telecommunications venture jointly owned by the two companies.[42] In July 1994, the FCC approved the alliance.[43] Approximately two weeks after the FCC's approval, the European Commission also approved the alliance.[44] The Justice Department's consent decree requires MCI, BT, and the joint venture to disclose certain information about arrangements between the companies and to fulfill certain conditions to ensure that no discrimination occurs.[45] The FCC imposed similar nondiscrimination obligations but still concluded that the deal was in the public interest and therefore waived section 310(b)(4)'s restrictions on foreign investment.[46]

Under the terms of the deal, BT paid $4.3 billion for one-fifth of MCI's outstanding shares, comprising one-fifth of the voting interest.[47] BT gained the right to nominate three of MCI's fifteen directors and the power to veto certain actions that MCI might take that could harm BT's interest in the company.[48]

Under the agreement, the two companies formed Concert, a joint venture to provide international enhanced voice and data services and the "global platform" (transmission,

42. United States *v.* MCI Comm. Corp., 1994-2 Trade Cas. (CCH) ¶ 70,730 (D.D.C. 1994).

43. MCI Comm. Corp., 9 F.C.C. Rcd. 3960 (1994).

44. *Europe Clears MCI-British Telecom Alliance*, N.Y. TIMES, July 29, 1994, at D3.

45. Department of Justice, Antitrust Division, United States *v.* MCI Comm. Corp. and BT Forty-Eight Co. ("Newco"), Public Comments and Response on Proposed Final Judgment, 59 FED. REG. 48642 (1994); *see also* AMERICAN BAR ASSOCIATION, SECTION OF PUBLIC UTILITY, COMMUNICATIONS AND TRANSPORTATION LAW, 1995 ANNUAL REPORT: INFRASTRUCTURE IN TRANSITION 140 (1995).

46. *MCI*, 9 F.C.C. Rcd. at 3964.

47. *Alliance With British Telecom Wins F.C.C. Approval*, N.Y. TIMES, July 15, 1994, at D3.

48. BRITISH TELECOMMUNICATIONS PUB. LTD. CO., 1994 SEC FORM 20-F, at 10 (1994).

switching, and other facilities) from which these services may be offered.[49] The services include international network services, frame relay, flexible bandwidth, outsourcing, and MCI's virtual private network service, as well as other products and services that the two companies will jointly develop.[50] BT owns 75.1 percent of Concert, and MCI owns the remaining 24.9 percent.[51] Concert presumably will not hold any U.S. radio licenses.

Given the size of BT's investment in MCI, the percentage of MCI's outstanding shares already held in foreign hands, and the possibility for the extent of foreign investment to fluctuate over time, MCI and BT sought a waiver from the FCC to allow the foreign ownership of MCI to exceed the 25 percent benchmark under section 310(b)(4). On August 23, 1993, BT and MCI filed a petition with the FCC for a declaratory ruling that BT's proposed 20 percent interest, which could raise the level of foreign investment in the American carrier as high as 28 percent at any given time, would be consistent with and permissible under section 310(b)(4).[52] The FCC granted the waiver, allowing foreign ownership in MCI to exceed the statutory threshold by 3 percent, based on its conclusion that the public interest would not be served by withholding its approval.[53]

MCI is a publicly traded U.S. corporation. It is the second largest long-distance carrier in the U.S. and provides a variety of domestic and international voice and data communications services.[54] MCI conducts most of its business through

49. Mary Lu Carnevale, *FCC Approves Purchase by BT of MCI Stake*, WALL ST. J., July 15, 1994, at B3.

50. BRITISH TELECOMMUNICATIONS PUB. LTD. CO., 1994 SEC FORM 20-F, at 10 (1994).

51. MCI COMMUNICATIONS CORP., 1994 SEC FORM 10-K, at 5 (1995).

52. *MCI*, 9 F.C.C. Rcd. at 3964.

53. *Id.*

54. MCI COMMUNICATIONS CORP., 1994 SEC FORM 10-K, at 4 (1995).

subsidiaries, which hold domestic common carrier microwave licenses, international facility authorizations, cable landing licenses, and other FCC licenses and authorizations.[55]

BT is the largest telecommunications operator in the U.K.[56] It provides local, long-distance, and international telephone service.[57] The former government-controlled telecommunications monopoly owns about 97 percent of the country's local access lines and has the U.K.'s most fully developed long-distance network. BT is the U.K.'s principal provider of international facilities-based services; the relatively new entrant, Mercury, is BT's only licensed competitor in this area. BT also offers a range of other telecommunications products and services, including private line circuits, mobile communications products, and paging.[58] BT is a public limited company in which the British government holds no more than 1.5 percent.[59]

As chapter 4 explained, the FCC decides on a case-by-case basis whether alien ownership or participation exceeding the 25 percent benchmark is in the public interest by considering the extent of U.S. presence in other areas of the company such as ownership, officers, or directors.[60] In deciding to grant its approval over the BT purchase and to permit the 3 percent waiver of the section 310(b)(4) limitation to account for the possible fluctuation in foreign ownership, the FCC

55. BRITISH TELECOMMUNICATIONS PUB. LTD. CO., 1994 SEC FORM 20-F, at 10 (1994).

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. *E.g.*, GRC Cablevision, Inc., 47 F.C.C. 2d 467 (1974) (allowing slightly more than 50 percent foreign ownership of the parent corporation of a radio licensee where the parent was a U.S. corporation with a majority of the board comprised of U.S. citizens, the aliens where from a nation traditionally friendly with the U.S., and the nature of the radio service was "largely passive.").